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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN ARIZONA
CORPORATION, FOR ADJUSTMENTS TO
ITS RATES AND CHARGES FOR UTILITY
SERVICE FURNISHED BY ITS NORTHERN
GROUP AND FOR CERTAIN RELATED
APPROVALS.

Docket No. W-01445A-00-0962

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides its Audit Report of Arizona Water Company's May 15, 2007 filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 1 rate increase for its Sedona, Oak Creek and Rimrock Service Territories.

RESPECTFULLY SUBMITTED this 3rd day of July 2007.


Arizona Corporation Commission
DOCKETED

JUL -3 2007

DOCKETED BY

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Daniel W. Pozefsky
Attorney

By 
Ernestine Gamble

1 AN ORIGINAL AND THIRTEEN COPIES
2 of the foregoing filed this 3rd day
3 of July 2007 with:

3 Docket Control
4 Arizona Corporation Commission
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6 Phoenix, Arizona 85007

7 COPIES of the foregoing hand delivered/
8 mailed this 3rd day of July 2007 to:

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TO: Stephen Ahearn, Director
Scott Wakefield, Chief Counsel
Marylee Diaz Cortez, Chief of Accounting and Rates

FROM: William A. Rigsby

DATE: July 3, 2007

RE: Report on RUCO's audit of Arizona Water Company's May 15, 2007 filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 1 rate increase for its Sedona, Oak Creek and Rimrock Service Territories.

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the capital expenditures of Arizona Water Company's ("Arizona Water" or "Company") recently completed arsenic removal facilities in the Company's Sedona and Rimrock service territories, to verify that the facilities are actually in service, to verify compliance with Decision Nos. 68310 and 66400 (which authorized the ACRM), and to verify the accuracy of the Company-requested ACRM surcharge. Arizona Water is seeking recovery of \$224,236 in capital expenditures related to the Company's Sedona system, and \$293,110 in capital expenditures related to the Company's Rimrock system.

AUDIT PROCEDURES: The following audit procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 are included in the application.
- 2) Reviewed Earnings Test for compliance, accuracy, and determined if the Company had passed the Earnings Test.
- 3) Reviewed all arsenic plant invoices, looking for such things as misallocations, unreasonable costs, non-arsenic plant costs, double billings etc.
- 4) Verified accuracy of Work Authorization Order totals and grand total.
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance.

- 6) Reviewed rate design for compliance with 50/50 requirement, accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the prior rate case.
- 7) Traveled to the arsenic removal facility sites and verified that the Sedona and Rimrock facilities are actually in service.

AUDIT FINDINGS:

This filing differed from prior ACRM filings because nine of the eleven arsenic removal facilities serving the Company's service areas (in Sedona and Rimrock) are being operated under lease agreements with a California-based firm known as Basin Water, Inc. ("Basin Water"). The other two arsenic removal facilities are U.S. Environmental Protection Agency ("EPA") demonstration labs that are in the process of being transferred to Arizona Water. No lease agreement exists on these two EPA demonstration labs. Both of the EPA demonstration labs are fully functioning arsenic removal facilities located at well sites in Sedona and Rimrock.

In regard to the nine leased Basin Water arsenic removal facilities, Arizona Water is only seeking recovery of site preparation and peripheral improvement costs that the Company was obligated to provide under the Company's lease agreements with Basin Water.

Upon completion of the transfer of the two EPA demonstration labs, Arizona Water will book the established value of the facilities as a contribution-in-aid-of-construction in conformance with the Company's formal agreement with the EPA. As with the leased Basin Water facilities, Arizona Water is only seeking recovery of site preparation and peripheral improvement costs that the Company was obligated to provide under Arizona Water's agreement with the EPA.

In the Company's response to a RUCO data request dated June 27, 2007, Arizona Water provided RUCO with a full explanation of the aforementioned transfer

of title on the two EPA demonstration labs and also provided RUCO with invoices that were not included in the Company's ACRM application.

Other than the aforementioned missing invoices, RUCO has not found any other discrepancies in the Company's ACRM Application.

AUDIT RECOMMENDATIONS:

The Company's ACRM request should be adopted by the Arizona Corporation Commission.